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No. ———

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1951

KIMBELL-DIAMOND MILLING COMPANY,
Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered in the above-entitled case on April 23, 1951.

Jurisdiction

Jurisdiction to review the decision below is granted by Sec. 1141(a) Internal Revenue Code.

Opinions Below

The opinion of the Tax Court of the United States is reported in 14 T.C. 74. The opinion of the Court of Appeals for the Fifth Circuit, which affirmed the Tax Court of the United States, is reported in 187 F. (2d) 718. On April 23, 1951, the Court of Appeals for the Fifth Circuit entered an order (unreported) denying a petition for rehearing filed in that Court.

Questions Presented

Two questions are presented by this proceeding. They are:

(a) Did the Tax Court of the United States err in again considering (and deciding differently) the precise issue litigated in that Court in a prior proceeding between the same parties, which prior proceeding involved the same properties, the same question of law, the same facts and the same evidence? There was no intervening change in the controlling "legal climate."

And, did the Court of Appeals for the Fifth Circuit err in affirming the decision of the Tax Court in the second proceeding—the case at Bar—which was adverse to taxpayer, and in failing to hold and adjudge that the doctrine of collateral estoppel (*Tait* v. *Western Maryland Ry. Co.*, 289 U.S. 620; *Commissioner of Internal Revenue* v. *Sunnen*, 333 U.S. 591) precluded a judicial re-examination of the Tax Court's former holding?

(b) Did the Tax Court of the United States, and the Court of Appeals for the Fifth Circuit, err in holding and deciding (contrary to the principles announced and applied by this Court in *United States* v. *Cumberland Public Service Company*, 338 U.S. 451, 70 S. Ct. 280) that it was permissible for those courts to read into a revenue statute, adopted after due deliberation and consideration by the Congress, and precisely worded by it, a condition contrary to the plain terms of the statute and, by judicial fiat, thereby to amend the statute, override the plainly expressed will and intention of the Congress, and deny to petitioner the right expressly accorded it by Sections 112(b)(6) and 113(a)(15) of the Internal Revenue Code to use as its basis for gain or loss, and depreciation, with respect to assets acquired through the complete liquidation of a corporation (Whaley Mill and Elevator Company) all of whose capital stock was owned by petitioner at the time of liquidation, the liquidated corporation's basis for assets distributed in liquidation, and, instead, to limit petitioner's basis for such assets to an aliquot part of the basis to petitioner of the capital stock of the liquidated corporation?

Statutes and Regulations Involved

The pertinent statutory provisions and applicable regulations are printed in Appendix I, *infra*, pp. 33 to 42.

Statement of the Case

The facts were all stipulated (R. 54-59). Briefly, they are:

In December 1942, Kimbell-Diamond Milling Company, this petitioner, purchased for cash from the owner and holder thereof all of the authorized, issued and outstanding capital stock of Whaley Mill and Elevator Company, a Texas corporation, hereinafter referred to as "Whaley." Petitioner had no dealings or negotiations of any sort with Whaley Company, itself. After Whaley's capital stock had been so acquired by petitioner, following the adoption of appropriate corporate resolutions, petitioner, on December 29, 1942, surrendered to Whaley for cancellation and retirement all of the capital stock of Whaley in consideration of the distribution to petitioner of all of Whaley's assets of every kind and character in complete liquidation and retirement of such stock. Whaley forthwith canceled and retired its said capital stock and, on December 31, 1942, surrendered its corporate charter. It ceased to exist from and after that date.

Petitioner, on its books, entered the assets taken over by it from Whaley at their depreciated cost to Whaley and, in its tax returns for its fiscal years ended May 31, 1943, 1944, 1945 and 1946, claimed deductions for the depreciation sustained by it within those taxable years with respect to the assets formerly belonging to Whaley, calculated by using Whaley's

cost or basis for such assets, which was greater than either the cost or basis to petitioner of Whaley's stock.[1] Petitioner based its action in this respect upon the provisions of Section 112(b)(6) and Section 113(a)(15) of the Internal Revenue Code. Whaley's former assets were also included in petitioner's invested capital at Whaley's cost or basis, rather than at petitioner's basis for Whaley's stock, in calculating the excess profits tax credit based upon invested capital claimed in petitioner's 1943, 1944, 1945 and 1946 excess profits tax returns.

The case at Bar involves deficiencies in income tax and excess profits tax asserted against petitioner for its fiscal years ended May 31, 1945 and 1946. The deficiency in income tax was based upon the action of the Commissioner of Internal Revenue in determining allowable depreciation by using as petitioner's basis for the assets acquired by it from Whaley the amount (adjusted)[1] paid by petitioner for Whaley's stock, rather than Whaley's former basis for such assets. As stated above, the former was a lesser amount than the latter. The deficiency in excess profits tax resulted from the action of the Commissioner of Internal Revenue in fixing the amount of invested capital to which petitioner was entitled, based on its ownership of Whaley's former assets, as the amount

[1]A part of the cash paid by petitioner for Whaley's stock was the proceeds of insurance collected as the result of a fire which destroyed property owned by petitioner. Because of this, under Section 112(f) of the Internal Revenue Code, petitioner's basis for Whaley's stock was less than the amount actually paid by petitioner for such stock.

paid by petitioner for Whaley's stock, rather than using Whaley's basis for its former assets.

The liability of Kimbell-Diamond Milling Company, this petitioner, for income taxes for its fiscal year ended May 31, 1943, had previously been before the Tax Court of the United States in a proceeding styled *Kimbell-Diamond Milling Company, Petitioner*, v. *Commissioner of Internal Revenue, Respondent*, Tax Court Docket No. 10982. The decision of the Tax Court in that proceeding is reported in 10 T.C. 7, et seq. In the notice of deficiency from which the earlier appeal was taken, the Commission of Internal Revenue made certain adjustments to income not here material, but allowed as a deduction from petitioner's income for its fiscal year ended May 31, 1943, the full amount of the depreciation claimed by petitioner in its return with respect to the assets formerly belonging to Whaley, which (as petitioner had done in its return) the Commissioner of Internal Revenue calculated by using Whaley's cost or basis for such assets.

Prior to the trial of this earlier proceeding (Docket No. 10982, in the Tax Court of the United States), the Commissioner of Internal Revenue, by amended pleadings (R. 35-51), attacked his own determination that petitioner had the right to use Whaley's basis for Whaley's former assets in calculating the depreciation sustained by petitioner in its fiscal year ended May 31, 1943, with respect to Whaley's former assets, and prayed for an increased deficiency. He voluntarily and affirmatively alleged:

(1) That the end result of petitioner's purchase of Whaley's stock, followed by the liquidation of that company, was the same as though petitioner had bought Whaley's stock and not Whaley's assets;

(2) That, because of this, although petitioner actually purchased stock, the transaction might be viewed, in substance, as a purchase of assets rather than a purchase of stock. If so viewed, petitioner's basis for Whaley's former assets was not governed by Sections 112(b)(6 and 113(a)(15) of the Internal Revenue Code;

(3) That, under the asset-purchase view, petitioner's basis for each of Whaley's former assets was an aliquot part of the amount paid by petitioner for Whaley's capital stock,[2] rather than Whaley's basis for such assets; and

(4) That, because in the statutory notice of deficiency in which the deficiency in income tax for the fiscal year ended May 31, 1943, was asserted he (the Commissioner of Internal Revenue) had allowed deductions for depreciation calculated by using Whaley's basis for its former assets, he had thereby allowed excessive deductions for depreciation in his determination of petitioner's net taxable income and tax liability for its fiscal year ended May 31, 1943, upon which the deficiencies determined by him in the statutory notice of deficiency

[2]Adjusted as required by Section 112(f), Internal Revenue Code.

from which the appeal in Docket No. 10982 was taken were based.

The affirmative issue thus squarely raised by respondent's amended answer and petitioner's reply thereto (a general denial) was: What was petitioner's basis for depreciation with respect to the assets asquired by it upon the complete liquidation of Whaley? Was it the basis claimed in petitioner's return (viz., Whaley's basis), or a rateable part of the amount (adjusted) paid by petitioner for Whaley's stock? This issue, the answer to which turned on whether what petitioner actually purchased in December 1942 was capital stock of Whaley, or Whaley's assets,[3] was tried before the Tax Court and briefed by both parties.

The Tax Court, in Docket No. 10982, refused to find that petitioner had been allowed excessive depreciation for its fiscal year ended May 31, 1943, and entered judgment pursuant to a computation in which depreciation for that year was allowed to petitioner on Whaley's former assets, calculated by using Whaley's basis therefor as petitioner's basis. Inherently, the order entered by the Tax Court constituted an adjudication by it that petitioner took Whaley's basis for Whaley's former assets.[4] No appeal was taken from such judgment of the Tax Court.

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[3]There was no controversy between the parties as to the useful lives of the Whaley assets, the only other factor involved in computing deductible depreciation thereon.

[4]*Restatement of the Law of Judgments*, Sec. 68, pp. 303-304. Respondent's affirmative allegations placed in issue the single question: What was the basis to petitioner of the assets acquired by it from Whaley?

The sole question of law presented for the determination of the Tax Court in the case at Bar was the identical one raised by respondent's affirmative pleadings in the prior appeal, namely: What was petitioner's basis for the depreciable assets acquired by it in connection with the complete liquidation of Whaley? Was it Whaley's basis for such assets, or petitioner's basis for Whaley's stock?

Notwithstandings its prior judgment, which found for petitioner on the depreciation issue and, therefore, found for petitioner on the basis question, the Tax Court again went into the basis question, and, *on the identical evidence concerning the manner in which Whaley's former assets were acquired by petitioner*, solely because the burden of proof was now on petitioner to overcome the prima facie presumption of the correctness of respondent's determination in this second proceeding that such was the case,[5] held that petitioner's basis for depreciation (and for invested capital) with respect to the same assets that were involved in the prior proceeding was an aliquot part of the adjusted cost to petitioner of Whaley's stock, rather than Whaley's former basis for such assets, and entered its order (R. 137) determining the deficiencies here before the Court.

The Court of Appeals for the Fifth Circuit, affirming the like holding of the Tax Court, refused to find that the bar of collateral judgment precluded a recon-

[5]There was no new testimony, evidence or stipulation with reference to the underlying facts in the second proceeding.

sideration of the basis question and, on the merits, sustained the Tax Court's holding that, because petitioner had purchased Whaley's stock with the intention of liquidating Whaley and taking over its assets, Sections 112(b)(6) and 113(a)(15) of the Internal Revenue Code did not apply. Such holding was directly contrary to the plain terms of the aforesaid sections, which provide that a taxpayer can, and *must*, take its transferor's basis for assets acquired in connection with the complete liquidation of another corporation, all of whose stock it owns at the time of liquidation, if:

(1) The assets are acquired in accordance with a program for the complete liquidation of the corporation whose stock is wholly owned;

(2) Taxpayer continues to own such stock until it is surrendered for cancellation in conformity with the plan of liquidation; and

(3) The liquidation is completed in the year begun.

The parties stipulated, and the Tax Court found, that the foregoing conditions had been met.

In denying petitioner the benefits of Sections 112(b)(6) and 113(a)(15) solely because petitioner had purchased Whaley's stock with the intention of liquidating Whaley and taking over its assets, the Tax Court and the Court of Appeals for the Fifth Circuit attached to the application of these sections a condition

contrary to their plain terms, thus, by judicial fiat, amending the sections and improperly overriding the plainly expressed will and intent of Congress.

Specification of Errors to be Urged

The Court of Appeals for the Fifth Circuit erred:

(1) In again considering, and deciding differently, the identical issue litigated in a prior proceeding between the same parties, involving the same properties, the same question of law, the same facts and the same evidence;

(2) In affirming the holding of the Tax Court that the purchase by petitioner of Whaley's stock and the subsequent liquidation of that corporation must be considered one transaction and as the purchase by petitioner of Whaley's assets, rather than of Whaley's stock;

(3) In holding and deciding that petitioner's invested capital is to be calculated and fixed by including in petitioner's invested capital the cost to petitioner of Whaley's stock, and in failing and refusing to hold and decide that the assets acquired by petitioner upon the complete liquidation of Whaley are to be included in petitioner's invested capital at their cost to Whaley;

(4) In holding and deciding that petitioner, in its fiscal year 1945 and 1946 returns, claimed excessive deductions for the depreciation sustained by it in those

taxable years with respect to the depreciable assets acquired by it in connection with the complete liquidation of Whaley;

(5) In failing and refusing to allow petitioner an adequate excess profits tax credit for the fiscal years 1945 and 1946;

(6) In affirming the determination of the Tax Court that petitioner is due deficiencies in tax for the years and in the amounts set out in the order of the Tax Court (R. 137) entered January 27, 1950; and

(7) In failing and refusing to hold and decide that petitioner is due no deficiencies in income tax, declared value excess profits tax or excess profits tax for either its fiscal year ended May 31, 1945 or May 31, 1946.

Reasons for Granting the Writ

I.

The writ herein prayed for should be granted because:

(1) The decision of the Tax Court of the United States, affirmed below by the Court of Appeals for the Fifth Circuit was wrong in that:

(a) In holding and deciding that the doctrine of collateral estoppel did not apply to the facts in the case at Bar, the Tax Court and the Court of Appeals

for the Fifth Circuit refused to recognize, and failed to apply, the principles clearly announced, and applied, by this Court in *Tait* v. *Western Maryland Ry. Co.*, 289 U.S. 620, and *Commissioner of Internal Revenue* v. *Sunnen*, 333 U.S. 591, and those announced and applied by the Courts of Appeal for the Sixth and Tenth Circuits in *Gillespie* v. *Commissioner*, 151 F. (2d) 903 (C.C.A. 10, 1945), cert. denied 328 U.S. 839 (1946), rehearing denied 328 U.S. 880 (1946); *Charles P. Leininger*, 29 B.T.A. 874 (1934), aff'd. 86 F. (2d) 791 (C.C.A. 6, 1936); *Robert H. Cory* (T.C. Memo Op., 1946) aff'd. 159 F. (2d) 39 (C.C.A. 3, 1946); *H. C. Jones, Collection of Internal Revenue*, v. *M. E. Trapp*, 186 F. (2d) 951 (C.C.A. 10, 1950); and *Hartford Empire Company* v. *Commissioner*, 137 F. (2d) 540 (C.C.A. 2, 1943).

(b) In holding and deciding, on the merits, that petitioner was not entitled to use Whaley's basis for depreciation, the Tax Court and the Court of Appeals for the Fifth Circuit wholly ignored the legislative history of Sections 112(b)(6) and 113(a)(15) of the Internal Revenue Code, read into these statutes restrictions and conditions not present therein, and failed and refused to apply the principle clearly announced by this Court in *United States* v. *Cumberland Public Service Company*, 338 U.S. 451, 70 S. Ct. 280, that where the Congress has designedly and specifically provided that certain tax results shall attach to the acquisition of property by

a particular method, if that method be followed, the specified conditions and results mandatorily attach, even though the property could have been transferred just as effectively in a different manner.

(2) A further and compelling reason why the writ herein prayed for should be granted is that the basis question involved in this proceeding is one that vitally affects a large segment of the economy of this nation. It is present in every case where one corporation acquires the capital stock of another corporation and liquidates the acquired corporation. The doubt, uncertainty and confusion created by the decision below should be dispelled by its reversal by this Court.

II.

We challenge the Government to deny that, in every case (and they are almost without exception) in which it is to the detriment of the taxpayer involved for Sections 112(b)(6) and 113(a)(15) to be applied in accordance with their carefully considered and plainly worded terms (viz.: where a high price is paid for the stock of a low basis corporation), the Treasury Department has so applied such sections. So far as has come to our attention, only in the case at Bar (which presents an exception to the usual situation that has prevailed since the enactment of Sections 112(a)(6) and 113(a)(15) Internal Revenue Code in that a low price was paid for the stock of a high basis corpora-

tion) has the Treasury Department deviated from its otherwise uniform procedure.

Earlier cases, such as *Commissioner of Internal Revenue* v. *Ashland Oil and Refining Company*, 99 F. (2d) 588, cert. denied, 306 U.S. 661, and *Koppers Coal Company* v. *Commissioner*, 6 T.C. 1209, judicially dealt, under prior revenue laws, with basis questions superficially similar to (but distinguishable from)[6] that here involved. If otherwise applicable here at all, however, the effect of these decisions was abrogated by the Congress by its enactment of Section 112(b)(6) of the Internal Revenue Code, brought into the revenue laws by Section 110(a) of the Revenue Act of 1935, and Section 113(a)(15) of the Internal Revenue Code, brought into the revenue laws by Section 113(a)(15) of the Revenue Act of 1936.[7]

In 1943, the Congress emphasized its intention that Sections 112(b)(6) and 113(a)(15) of the Internal Revenue Code were to be construed in accordance with their plainly expressed terms by spelling out, in precise language, the only circumstance under which any

[6]In the *Ashland* case, only part of the corporation's assets were transferred. In the *Koppers* case, the acquired corporations also were first stripped of assets not desired by Koppers, and, moreover, the same result would have been reached by merely applying the reorganization provisions of the statute to the facts in the case, regardless of whether the purchase was of stock or of assets—cf: 6 T.C. 1209, pp. 1219-1222, inclusive.

[7]See: *Liquidation of Newly Acquired Subsidiaries*, by Francis X. Mannix; *Taxes*—The Tax Magazine, December 1948 issue (page 1112 et seq.)

benefits a taxpayer might otherwise derive under those sections were to be denied to the taxpayer. This it did by enacting Section 129 of the Internal Revenue Code, added to the Code by Section 128(a) of the Revenue Act of 1943. The purpose of Section 129 of the Internal Revenue Code was to deny to a taxpayer under the circumstances described therein, and only under those particular circumstances, any benefit from the application of Sections 112(b)(6) and 113(a)(15) to which it otherwise would be entitled. The Congress did not then see fit, however, to ameliorate any *detriments* a taxpayer might suffer through the strict application of those sections.

It has never been contended by the Government, and there are no grounds for any such contention, that Section 129 of the Internal Revenue Code has any application in the case at Bar.

Sections 112(b)(6) and 113(a)(15) Internal Revenue Code, as implemented by Section 129, Internal Revenue Code, in many cases, tended to produce harsh results, and their revision was recommended by a special tax study committee (appointed by the House Ways and Means Committee), headed by the Honorable Roswell Magill, in its report to the Ways and Means Committee, dated November 5, 1947,[1] and by the Tax Section of the American Bar Association at the September, 1950, convention of the Association. See: *Reports of American Bar Association* (1950, Vol.

[1]Appendix II, p. 43.

75, pp. 132-133.[9] Notwithstanding such recommendations, the Congress has steadfastly refused to amend the inflexible provisions of the said Sections 112(b)(6) and 113(a)(15) of the Internal Revenue Code, as modified by Section 129 of the Internal Revenue Code.

We respectfully submit that the decision of the Tax Court of the United States and of the Court of Appeals for the Fifth Circuit, below, if not reversed by this Court, by judicial fiat will amend Sections 112(b)(6) and 113(a)(15) in a manner and to an extent that the Congress has specifically refused to do in spite of recommendations to it by an advisory committee of outside tax experts appointed by one of its own branches, and by the Tax Bar of the nation, speaking through the Tax Section of the American Bar Association. This, alone, affords ample reason for reversing the decision below.

The decision below has confused and perplexed corporate management generally, and has been the subject of critical comment in law review articles[10] and business magazines.[11]

The case at Bar presents questions of material importance in the administration of the Federal revenue laws, questions of such importance that they merit an authoritative decision by this Court.

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[9]Appendix III, p. 44.

[10]*American Bar Association Journal*, May 1950, p. 418.

[11]Appendix IV, pp. 46 to 54.

Conclusion

For the foregoing reasons, and for the reasons set out in the supporting brief attached hereto, this petition for certiorari should be granted.

Respectfully submitted,

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No. ————

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1951

KIMBELL-DIAMOND MILLING COMPANY,
Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

In the brief that follows, we will undertake to set out the basis of certain categorical assertions made in the petition herein for a writ of certiorari and, concisely, to submit certain additional reasons why the writ should be granted.

Jurisdiction

Jurisdiction to review the decision below is granted by Sec. 1141(a) Internal Revenue Code.

Opinions Below

The prior judicial history of this proceeding is set out in the petition herein at page 2, to which reference is hereby made.

Questions Presented

The questions presented are fully stated at pages 2 to 3 of the petition herein, which by reference are incorporated in and made a part of this supporting brief.

Statutes and Regulations Involved

The pertinent statutory provisions and applicable regulations are printed in Appendix I, *infra*, pages 33 to 43.

Statement of the Case

The facts were all stipulated (R. 54-59). They are briefly summarized at pages 4 to 11 of the petition herein and will not be repeated here.

Specification of Errors to be Urged

The errors to be urged are specified at pages 11 to 12 of the petition herein, to which reference is hereby made.

Reasons for Granting the Writ

The primary reasons why the writ herein prayed for should be granted are set out at pages 12 to 17 of the petition herein. The purpose of this supporting brief is to explain and corroborate certain assertions made in the petition which may require elaboration.

I.

The Doctrine of Collateral Estoppel Precludes the Consideration and Adjudication in this Proceeding of the Identical Issue Litigated by the Same Parties in a Prior Proceeding

If, as asserted in the petition herein, the sole issue involved in this proceeding presented for judicial determination the identical issue litigated by the same parties in a prior proceeding, it cannot well be questioned that the doctrine of collateral estoppel precluded the reconsideration in the proceeding below of that same issue (*Tait* v. *Western Maryland Ry. Co.*, 289 U.S. 620; *Commissioner of Internal Revenue* v. *Sunnen*, 333 U.S. 591).

In its opinion and decision in the case at Bar, affirmed by the Circuit Court below, the Tax Court stated that the basis issue present in this case was not decided by it in the first suit (Docket No. 10982). In the opinion in the first suit, said the Tax Court, "We expressly stated that we were not deciding this issue." **(R. 133).**

Despite the foregoing statement of the Tax Court in its opinion in the case at bar, we respectfully assert that it *did* decide the basis issue in the first suit. It is true that, in its *opinion* in Docket No. 10982 (in which it held for petitioner with respect to the involuntary conversion issue that originally was the sole issue in that case), the Tax Court (10 T.C. 7, pp. 13 and 14), with respect to the basis issue voluntarily injected in the first proceeding by respondent's affirmative pleadings, (R. 35-51) used the following language:

> "Upon the legal premise that the basis of the Whaley assets in petitioner's hands is the lower basis determined pursuant to sections 112(f) and 113(a)(9), respondent c l a i m s that petitioner realized additional income from sales and that depreciation originally allowed was excessive. If the position respondent now urges had been the basis for his original determination, with the burden of proof on the taxpayer to establish the contrary, we would have a different situation. But the burden rests on the party affirmatively raising these questions—here, the Commissioner—to establish not only the legal premises, but also all the material facts necessary to support his claims for the additional items of income. Even if he be right as to the proposition of law advanced, he has offered no factual basis to form a predicate for his claims that petitioner realized additional income. * * * * *
>
> * * * * *
>
> "In this state of the record we prefer not to decide, in this proceeding, the legal question as to

whether the purchase of shares in Whaley by the petitioner constitutes as a matter of law the acquisition of Whaley assets. We leave that question open for determination in any appropriate proceeding involving a later year, where a record presenting an adequate factual basis may be made. *We shall let the present case rest on the issue raised in the petition and answer, founded on the determination as made by the Commissioner in the first instance.*" (Emphasis supplied)

This immediately leads to the inquiry: Did the above-quoted language of the Tax Court have any foundation, either in fact or in law? We shall proceed to analyze the controlling facts and circumstances, and to demonstrate that it did not.

Before undertaking such analysis, we believe it would be helpful to review the mechanics whereby the Tax Court of the United States adjudicates the tax liability of a petitioner in that Court.

The procedure in the Tax Court of the United States is rather unique as legal procedures go. In ordinary litigation in civil cases, the proceeding is initiated by a petition or a complaint whereby the plaintiff alleges facts that would entitle him to specified relief, and prays that the Court grant him such relief. The defendant, or respondent, files an answer; the issue, or issues, are thereby joined; testimony and evidence are introduced, or the facts stipulated; and the court adjudicates the issue, or issues, raised by the pleadings.

In the Tax Court, however, the procedure is radically different. The Commissioner of Internal Revenue, through his duly appointed agents, first makes an examination of taxpayer's return, and, if he considers it to disclose tax liability less than that legally due, advises the taxpayer that he proposes to assert a deficiency in tax. The taxpayer is afforded an opportunity to object to such proposed deficiency in informal conferences, and, if it is impossible for the taxpayer and the Commissioner's subordinates to reach an agreed disposition of a disputed tax liability, a statutory notice of dificiency is mailed by the Commissioner to the taxpayer (Section 272, I.R.C.), which statutory notice of deficiency constitutes an *administrative adjudication* of the tax liability of the particular taxpayer involved. The taxpayer may then appeal to the Tax Court for a redetermination of any deficiency declared in any such statutory notice of deficiency. Rule 32 of the Rules of Practice of the Tax Court of the United States provides that, in any proceeding before it, "the burden of proof shall be upon the petitioner, except as otherwise provided by statute, and *except that in respect of any new matter pleaded in his answer, it shall be upon the respondent.*" (Emphasis supplied)

It will thus be seen that, in so far as proceeding before the Tax Court of the United States are concerned, the statutory notice of deficiency provided for by Section 272 of the Internal Revenue Code serves the dual function of both the usual petition or complaint and of a judgment. Unless the taxpayer perfects an appeal

therefrom to the Tax Court of the United States, tax liability is fixed thereby, and assessment and collection follow. Where the taxpayer does perfect an appeal to the Tax Court, unless such administrative adjudication is overcome by testimony and evidence adduced by the taxpayer at the trial in the Tax Court, or unless the Commissioner by an affirmative pleading attacks his own determination in the statutory notice of deficiency and successfully sustains his affirmative pleading by competent testimony and evidence, the administrative adjudication accomplished by the mailing of the statutory notice of deficiency must be affirmed by the Tax Court of the United States. A proceeding in the Tax Court, therefore, is not, strictly speaking, de novo. As its name indicates, it is an *appeal* from an administrative adjudication, but an appeal wherein each party has the right to present evidence against or in support of its correctness.

In the earlier proceeding (Tax Court Docket No. 10982) involving the tax liability of petitioner corporation for its fiscal year ended May 31, 1943, the Commissioner, in the statutory notice of deficiency from which petitioner's appeal to the Tax Court in that case was taken, administratively "determined" (i.e., adjudged) that petitioner took Whaley's basis for the assets acquired by it in connection with the complete liquidation of Whaley at a time when petitioner owned all of Whaley's capital stock, and allowed deductions for depreciation calculated by using such basis. After the notice of deficiency was mailed, taxpayer's petition filed, and respondent had answered same, respondent concluded that he was in error in his original de-

termination and, by an amendment to the answer originally filed by him in Docket No. 10982, affirmatively alleged (R. 35-51) that, in the statutory notice of deficiency from which the appeal in Docket No. 10982 was taken, he had (R. 36) "erroneously determined that petitioner took the assets of Whaley Mill and Elevator Company at Whaley's adjusted basis of $328,736.59, whereas, the proper basis of petitioner * * * is $224,020.90," of which, he alleged, $50,182.93 was allocable to depreciable assets. At the trial, respondent failed to prove that he had erred in the respects alleged in his "amendment to answer," and his original determination as to basis and depreciation sustained was affirmed in the order of redetermination (R. 137) that constituted the *judgment* of the Tax Court, as distinguished from its *opinion*.

As previously stated herein, in its opinion in Docket No. 10982, however, the Tax Court, after reciting that the burden rested upon the Commission to support the affirmative allegations contained in his "amendment to answer," and that the Commissioner had failed to meet this burden, said that, "in this state of the record," it preferred not to decide in that proceeding the legal question as to whether the purchase of shares in Whaley by petitioner constituted, as a matter of law, the acquisition of Whaley's assets, but would leave that question open for determination in any appropriate proceeding involving a later year where a record presenting an actual factual basis might be made. The Court concluded this part of its opinion by saying, "We shall let the present case rest on the issue raised in

the petition and answer, founded on the determination as made by the Commission in the first instance."

Not withstanding the language used in its *opinion*, the Tax Court *did* adjudicate the issue raised by Respondent's affirmative pleadings in Docket No. 10982 in the *judgment* entered by it in the 1943 case. It did so by affirming (i.e., by refusing to overrule, and by proceeding to "let rest") the administrative adjudication made by the Commissioner in the statutory notice of deficiency from which taxpayer's appeal in the first case was taken that petitioner's basis for the assets acquired by it from Whaley was Whaley's basis, and by refusing to find the increased deficiences prayed for by Respondent.

We respectfully assert that, when consideration is given to the mechanics involved in a trial before the Tax Court of the United States, no other conclusion fairly can be reached than that the judgment of the Tax Court in Docket No. 10982 constituted an adjudication by it that petitioner's basis for Whaley's former assets was the same as Whaley's basis therefor.

The doctrine of *res judicata* and *estoppel by judgment*, the latter sometimes termed *"collateral estoppel,"* are firmly imbedded in American jurisprudence. Underlying both is the principle that, once a party has fought out a matter in litigation with another party, he cannot renew that duel. The concepts of both doctrines are applicable in the Federal income tax fields. (*Commissioner of Internal Revenue* v. *Sunnen*,

333 U.S. 591). It is the doctrine of collateral estoppel that is applicable here, since this proceeding involves a second action by the same parties, upon a different cause or claim. This is so because Federal taxes for the fiscal year ended May 31, 1943 were involved in the first proceeding, and Federal taxes for the fiscal years ended May 31, 1945 and 1946 are involved in the case at Bar. Income taxes being levied upon an annual basis, each year is the origin of a new liability and a separate cause of action (*Commissioner of Internal Revenue* v. *Sunnen, supra*). Under the doctrine of estoppel by collateral judgment, it is well settled that a fact squarely placed in issue in an earlier proceeding may not again be put at issue in a second proceeding between the same parties, although the second proceeding may be upon a different cause or claim. (*Commissioner of Internal Revenue* v. *Sunnen, supra*)

At the time of the trial of Docket No. 10982, the acquisition by petitioner of Whaley's assets had long since been fully consummated. All of the facts with respect to this transaction, and all the documents involved, were in existence and were fixed and immutable. They were the same at the time of the first trial as they were at the time of the trial of the case at Bar. There had been no intervening change in "judicial climate."[1] The facts presented to the court in

[1]Decisions dealing with the doctrine of estoppel by collateral judgment as applied to the manner of taxing trust income, whether a partnership is to be recognized for Federal tax purposes and like questions involving different taxable years are wholly inapplicable in the present proceeding because they involve questions of *status*, as to

the second proceeding, the case at Bar, were all stipulated and were the same facts that the Tax Court had found in the first proceeding. As hereinbefore stated, the second proceeding involved the same question of law, the same facts and the same evidence. The only difference between the state of the record in the first proceeding and the state of the record in the second proceeding, and the only difference in the "factual basis" before the court in the first and second proceedings, was that, in the statutory notice of deficiency from which the appeal in the second proceeding (the case at Bar) was taken, respondent administratively "determined" that petitioner's aggregate basis for Whaley's former assets, and the amounts thereof to be allocated as between various specific assets, were the same amounts he had affirmatively alleged in the prior proceeding, but failed to prove by competent evidence. Solely because the burden of proof was now on petitioner to overcome the prima facie presumption of the correctness of respondent's determination in this second proceeding, the basis issue involved therein was decided against petitioner.

In summary, the basis issue involved in this proceeding was squarely presented to the Tax Court of the United States in the first proceeding by proper pleadings. It was litigated by the parties in the first trial and, notwithstanding the language contained in

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which the controlling facts are never static or immutable but can and do change from day to day, and the legal concepts with respect to which are subject to doctrinal changes sometimes referred to as changes in "legal climate." (*Commissioner v. Sunnen, supra*)

the Court's opinion in that case, was actually decided in the judgment entered in the first proceeding. We respectfully assert that, where a question of law, the decision of which, when raised, is indispensible to the entry of a proper judgment in the case, is squarely presented to the Tax Court by proper pleadings, is tried, and is decided adversely to the party affirmatively pleading the same, the Tax Court (even though the losing party be the Government), by merely stating in its *opinion* that it proposes "to leave that question open for determination in any appropriate proceeding involving a later year where a record presenting an adequate factual basis may be made," cannot leave a litigated issue, actually decided in its *judgment*, dangling in mid air and expose the prevailing party to the expense and hazard of relitigating the identical issue in a later proceeding, one in which the burden of proof is on him and not on the party who voluntarily and affirmatively raised the issue at the first trial.

If the doctrine of estoppel by collateral judgment is applicable in the field of Federal income taxation at all, and this Court has expressly said that it is in *Commissioner of Internal Revenue* v. *Sunnen*, *supra*, the decision below should be reversed by this Court. Otherwise, this Court should overrule its earlier decisions in *Tait* v. *Western Maryland Ry. Co.*, 289 U.S. 620, and *Commissioner of Internal Revenue* v. *Sunnen*, 333 U.S. 591.

II.

Petitioner is Entitled to Prevail in This Proceeding on the Merits

The reasons why petitioner is entitled to prevail on the merits are concisely, but adequately, set out under "Reasons for Granting the Writ," at pages 12 to 17, of the petition herein. We will not further burden the Court by repeating what is said there.

We would like, however, to leave this thought with the Court: Under the controlling statutes, in a situation where the stock of a corporation owning assets having a basis in its hands of $100,000.00, but worth $1,000,000.00, or more, is purchased by another corporation for $1,000,000.00 in cash, and the first corporation liquidated (and since the enactment of Sections 112(b)(6) and 113(a)(15) of the Internal Revenue Code, this, or a substantially similar result, has occurred many more times than the converse) the acquiring corporation is limited to a basis of $100,000.00 for the assets acquired in the liquidation, although the stock of the liquidated corporation cost it ten times that sum in actual cash.

If it is just and right for the Congress to limit basis in the manner above set out, it is equally just and right for petitioner to insist that it be given as its basis for Whaley's former assets the actual c o s t thereof to Whaley, although that cost was greater than t h e amount paid by petitioner for Whaley's stock.

Simple justice requires that taxing statutes remain two-way streets.

Conclusion

For the foregoing reasons, and for the reasons set out in the petition herein, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX I

INTERNAL REVENUE CODE:

Section 112. Recognition of Gain or Loss.

(a) General Rule.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under Section 111, shall be recognized, except as hereinafter provided in this section.

(b) Exchanges solely in kind.—

* * * * *

(6) Property received by corporation on complete liquidation of another.—No gain or loss shall be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation. For the purpose of this paragraph a distribution shall be considered to be in complete liquidation only if—

(A) the corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 per centum of the total number of shares of all other classes of stock (except nonvoting stock

which is limited and preferred as to dividends), and was at no time on or after the date of the adoption of the plan of liquidation and until the receipt of the property the owner of a greater percentage of any class of stock than the percentage of such class owned at the time of the receipt of the property; and

(B) no distribution under the liquidation was made before the first day of the first taxable year of the corporation beginning after December 31, 1935; and either

(C) the distribution is by such other corporation in complete cancellation or redemption of all its stock, and the transfer of all the property occurs within the taxable year; in such case the adoption by the share holders of the resolution under which is authorized the distribution of all the assets of such corporation in complete cancellation or redemption of all its stock, shall be considered an adoption of a plan of liquidation, even though no time for the completion of the transfer of the property is specified in such resolution; or

(D) such distribution is one of a series of distributions by such other corporation in complete cancellation or redemption of all its stock in accordance with a plan of liquidation under which the transfer of all the property under the liquidation is to be completed within three years from the close of the taxable year during which is made the first

of the series of distributions under the plan, except that if such transfer is not completed within such period, or if the taxpayer does not continue qualified under subparagraph (A) until the completion of such transfer, no distribution under the plan shall be considered a distribution in complete liquidation.

If such transfer of all the property does not occur within the taxable year the Commissioner may require of the taxpayer such bond, or waiver of the statute of limitations on assessment and collection, or both, as he may deem necessary to insure, if the transfer of the property is not completed within such three-year period, or if the taxpayer does not continue qualified under subparagraph (A) until the completion of such transfer, the assessment and collection of all income, war profits, and excess profits taxes then imposed by law for such taxable year or subsequent taxable years, to the extent attributable to property so received. A distribution otherwise constituting a distribution in complete liquidation within the meaning of this paragraph shall not be considered as not constituting such a distribution merely because it does not constitute a distribution or liquidation within the meaning of the corporate law under which the distribution is made; and for the purposes of this paragraph a transfer of property of such other corporation to the taxpayer shall not be considered as not constituting a distribution (or one of a series of distributions) in complete

cancellation or redemption of all the stock of such other corporation, merely because the carrying out of the plan involves (i) the transfer under the plan to the taxpayer by such other corporation of property, not attributable to shares owned by the taxpayer, upon an exchange described in paragraph (4) of this subsection, and (ii) the complete cancellation or redemption under the plan, as a result of exchanges described in paragraph (3) of this subsection, of the shares not owned by the taxpayer.

* * * * *

(26 U.S.C., 1946 ed., Sec. 112.)

Sec. 113. Adjusted Basis for Determining Gain or Loss.

(a) Basis (unadjusted) of property.—The basis of property shall be the cost of such property; except that—

* * * * *

(9) Involuntary conversion.—If the property was acquired, after February 28, 1913, as the result of a compulsory or involuntary conversion described in section 112(f), the basis shall be the same as in the case of the property so converted, decreased in the amount of any money received by the taxpayer which was not expended in accordance with the provisions of law (applicable to the year

in which such conversion was made) determining the taxable status of the gain or loss upon such conversion, and increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized upon such conversion under the law applicable to the year in which such conversion was made.

* * * * *

(15) Property received by a corporation on complete liquidation of another.—If the property was received by a corporation upon a distribution in complete liquidation of another corporation within the meaning of section 112(b)(6), then the basis shall be the same as it would be in the hands of the transferor. The basis of property with respect to which election has been made in pursuance of the last sentence of section 113(a)(15) of the Revenue Act of 1936, as amended, shall, in the hands of the corporation making such election, be the basis prescribed in the Revenue Act of 1934, as amended.

* * * * *

(26 U.S.C. 1946 ed., Sec. 113.)

Sec. 718 (as added by Sec. 201, Second Revenue Act of 1940, c. 757, 54 Stat. 974). Equity Invested Capital.

(a) Definition.—The equity invested capital for any day of any taxable year shall be determined

as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b)—

* * * * *

(5) Increase on account of gain on tax-free liquidation.—In the case of the previous receipt of property (other than property described in the last sentence of section 113(a)(15)) by the taxpayer in complete liquidation of another corporation under section 112(b)(6), or the corresponding provision of a prior revenue law, an amount, with respect to each such liquidation equal to the amount by which the aggregate of the amount of the money so received and of the adjusted basis, at the time of receipt, of all property (other than money) so received, exceeds the sum of:

(A) The aggregate of the adjusted basis of each share of stock with respect to which such property was received; such adjusted basis of each share to be determined immediately prior to the receipt of any property in such liquidation with respect to such share, and

(B) The aggregate of the liabilities of such other corporation assumed by the taxpayer in connection with the receipt of such property, of the liabilities (not assumed by the taxpayer) to which such property so received was subject, and of any other consideration (other than the stock with re-

spect to which such property was received) given by the taxpayer for such property so received;

* * * * *

(26 U.S.C. 1946 ed., Sec. 718.)

Sec. 129. Acquisitions Made to Evade or Avoid Income or Excess Profits Tax.

(a) Disallowance of Deduction, Credit, or Allowance.—If (1) any person or persons acquire, on or after October 8, 1940, directly or indirectly, control of a corporation, or (2) any corporation acquires, on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately prior to such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation, and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income or excess profits tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed. For the purposes of clauses (1) and (2), control means the ownership of stock possessing at least 50 per centum of the total combined voting power of all classes of stock entitled to vote or at least 50 per

centum of the total value of shares of all classes of stock of the corporation.

(b) Power of Commissioner to Allow Deduction, Etc., in Part.—In any case to which subsection (a) is applicable the Commissioner is authorized—

(1) to allow as a deduction, credit, or allowance any part of any amount disallowed by such subsection, if he determines that such allowance will not result in the evasion or avoidance of Federal income and excess profits tax for which the acquisition was made; or

(2) to distribute, apportion, or allocate gross income, and distribute, apportion, or allocate the deductions, cerdits, or allowances the benefit of which was sought to be secured, between or among the corporations, or properties, or parts thereof, involved, and to allow such deductions, credits, or allowances so distributed, apportioned, or allocated, but to give effect to such allowance only to such extent as he determines will not result in the evasion or avoidance of Federal income and excess profits tax for which the acquisition was made; or

(3) to exercise his powers in part under paragraph (1) and in part under paragraph (2).

TREASURY REGULATIONS 111, promulgated under the Internal Revenue Code:

Sec. 29.112(b)(6)-5. Records to be Kept and Information to be Filed with Return.—

(a) Permanent records in substantial form shall be kept by every corporation receiving distributions in complete liquidation within the exception provided in section 112(b)(6) showing the information required by this section to be submitted with its return. The plan of liquidation must be adopted by each of the corporations parties thereto; and the adoption must be shown by the acts of its duly constituted responsible officers, and appear upon the official records of each such corporation.

(b) For the taxable year in which the liquidation occurs, or, if the plan of liquidation provides for a series of distributions over a period of more than one year, for each taxable year in which a distribution is received under the plan, the recipient shall file with its return a complete statement of all facts pertinent to the nonrecognition of gain or loss, including—

(1) A certified copy of the plan for complete liquidation, and of the resolutions under which the plan was adopted and the liquidation was authorized, together with a statement under oath showing in detail all transactions incident to, or pursuant to, the plan.

(2) A list of all the properties received upon the distribution, showing the cost or other basis of such properties to the liquidating corporation at the date of distribution and the fair market value of such porperties on the date distributed.

(3) A statement as to its ownership of all classes of stock of the liquidating corporation (showing as to each class the number of shares and percentage owned and the voting power of each share) as of the date of the adoption of the plan of liquidation, and at all times since, to and including the date of the distribution in liquidation, and the cost or other basis of such stock.

APPENDIX II

Special Tax Study Committee Report, dated November 5, 1947 (Magill Committee appointed by the House Ways and Means Committee to advise on general tax provisions):

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* * * * *

"26. Basis of Assets Acquired by a Corporation upon Liquidation of Another.

"We recommend that Section 113(a)(6) and (a)(15) be amended so as to provide that (1) if a liquidation or taxfree exchange occurs within a reasonable period from the date of acquisition of 80 per cent or more of the voting stock of the transferor corporation, and (2) the transferee can demonstrate that the stock of the transferor was acquired for the express purpose of obtaining and integrating the underlying assets with those of the transferee, the basis of the properties received shall be the same as that of the stock or other securities for which such properties were received."

APPENDIX III

Recommendation 5 of the Section of Taxation of the American Bar Association, adopted September, 1950 (*Reports of American Bar Association*, Vol. 75, 1950, pp. 132-133):

* * * * *

5. Effect of Dissolution of Subsidiary Corporation by Parent (Section 112(b)(6) I.R.C.)

Resolved, That the American Bar Association recommend to the Congress that the provisions of the Internal Revenue Laws relating to the recognition of gain or loss upon the receipt by a corporation of property distributed in complete liquidation of another corporation be amended in order that gain or loss shall be recognized on certain liquidations and that the basis of such property shall not carry forward, notwithstanding compliance, otherwise, with the requirements of the said Section 112(b)(6); and

Resolved, That clarification is required in order to make certain that a corporation which purchases the stock of another corporation and promptly adopts a plan of complete liquidation of such other corporation shall not be reqired to use the basis of the property in the hands of the liquidated corporation, which may be substantially less than the cost of the acquired stock; and

Resolved, That the Association propose that this purpose be accomplished by the amendment of Section 112(b)(6) of the Code to provide that if the acquiring corporation so elects, Section 112(b)(6) shall not apply where the plan of complete liquidation is adopted within six (6) months after such corporation has completed the acquisition of the amount of stock specified in subparagraph (A) of Section 112(b)(6); and

Be it Further Resolved, That the Officers and Council of the Section of Taxation are directed to urge the following amendment, or its equivalent in purpose and effect, upon the proper committees of Congress:

"Section 112(b)(6) of the Internal Revenue Code is hereby amended by adding, without number or designation, the following sentence: 'If the corporation receiving such property so elects (in accordance with regulations prescribed by the Commissioner with the approval of the Secretary), this paragraph shall not apply in any case in which the plan of complete liquidation is adopted within six (6) months after such corporation has completed the acquisition of the amount of stock specified in subparagraph (A).'"

APPENDIX IV

"Must Taxpayers Be Mind Readers?"

by John P. Allison

(Fortune Magazine, April, 1951 Issue, Page 85.)

"As tax rates approach wartime severity, the complexity and erratic interpretation and administration of U.S. tax law become an increasingly serious business hazard. In many types of transactions the taxpayer, individual as well as corporate, can only guess at the position of the Bureau of Internal Revenue and hope for the best. But a bad guess that was merely expensive at pre-Korea rates could be ruinous at 1951 rates.

"In the article below, an able New York attorney, John P. Allison, author of a number of publications on tax problems, proposes five reforms that would help the taxpayer figure out what he is going to owe.

* * * * *

"Koppers Co. was willing to pay $7,600,000 for coal properties owned by other corporations. At this price the sellers would have realized a handsome profit less a capital-gain tax. Then their stockholders would have had to pay individual capital-gain taxes on obtaining

their cash. To save the second tax on one profit, the stockholders suggested that Koppers buy their stock. That raised a problem for Koppers: if it had to pay $7,600,000, it wanted to figure future depreciation deductions on that cost, not on the sellers' much lower cost base. By purchasing stock and then liquidating the sellers, it would inherit the sellers' base. Impasse.

"Thereupon some brave soul advised Koppers that, regardless of the form of the transaction, it was really buying mines and plant, not stock; and, since Substance triumphs over Form when sponsored by the Treasury, it should also do so when sponsored by the taxpayer. So Koppers bought the stock, liquidated the sellers, computed depreciation on the cost of the stock, fought the Treasury in the Tax Court, and won its point.

"Ordinarily, when the Commissioner of Internal Revenue loses a case of this importance, he publicly announces his 'acquiescence' or 'non-acquiescence.' 'Acquiescence' means that taxpayers may rely on the decision. 'Non-acquiescence' is a bar sinister—a warning that reliance means litigation. But the Commissioner has yet to indicate that he will grant approval in advance of a Koppers-type transaction. He hasn't said yes and he hasn't said no—though the Tax Court handed down its decision five years ago.

"The Commissioner's inability to decide whether the Koppers decision is good law did not faze him when the Kimbell-Diamond Milling Co. bought stock of a

company owning a high-basis plant. He argued that the transaction was a purchase of assets, not stock. Thus it appears that the Treasury will cheerfully fight either side of this question, depending on which will yield the more tax.

"This is merely one illustration of the tax uncertainties that envelop many common business transactions. Another is the muddled status of executives' deferred compensation (*Fortune*, May, 1949). Such doubts hurt the economy by impairing the transferability of property and discouraging the assumption of business risks. Is there any way of checking this blight—of bringing more certainty into taxes?

"A distinguished former Under Secretary of the Treasury, Arthur Ballantine, has suggested that all will be well 'when courts return to permitting the tax statutes to stand as written by Congress.' Unfortuneately the problem is not so simple as that. Tax statutes cannot possibly anticipate many of the specific situations that emerge in our vastly varied and complex commercial life.

"Properly, the courts have assumed the power to guess what would have been done had a particular case received legislative attention. Frequently there are clues in a legislative committee report or debate. Sometimes a general intention is apparent. And, of course, the problem is not peculiar to tax statutes, or even to legislation. It exists whenever two litigants draw different conclusions from the same words—be

they in a statute, a contract, or a will. 'A word is not a crystal, transparent and unchanged; it is the skin of a living thought,' observed Mr. Justice Holmes. It is a judge's duty to extract that thought.

"But this does not mean that the courts are entirely free of responsibility for the current tax confusion. In too many cases, as Justice Frankfurter recently charged, 'the court appears to be guided—in construing the applicable provisions of the Internal Revenue Code by the urgent need for revenue.' Such exercise of the judicial power inevitably creates uncertainty. The various parts of the law are so intertwined that a revenue-producing construction of one section may have a revenue-losing repercussion elsewhere—and then how construe the latter provision?

"We must probe deeper than the courts. A logical starting point is the Internal Revenue Code, the backbone of the tax structure. From the four-page income-tax statute of 1913, our basic federal tax law has proliferated into a fantastically complicated document of more than 300 pages. So distinguished a jurist as Leonard Hand has confessed that the words of the Income Tax (Act) '—dance before my eyes in a meaningless procession: cross reference to cross reference, exception upon exception—couched in abstract terms that offer no handle to seize—' (And he said this before he had seen the excess-profits legislation of 1950.)

"For this chaos the Treasury must share responsibility with Congress and the courts. As the interpre-

tation and enforcement agency, the Treasury has framed the issues that have produced interminable litigation—and doubts—on such matters as division of family income, unreasonable accumulation of corporate earnings, stock redemptions, etc. Until the Treasury takes a stand and a taxpayer fights back, the courts do not enter the picture. And, as illustrated by the Kimbell-Diamond case, all too often one Treasury stand is inconsistent with others it has taken elsewhere.

"Also objectionable is the Treasury's refusal to take a position on many pressing questions. Because of the severe penalty for a bad tax guess, the Treasury's inaction produces the same effect as would an adverse ruling—but without the enlightenment, as to reasons, that such a ruling would provide.

"In view of all this, the Internal Revenue Code should be rewritten, a task monumental but not impossible. The American Law Institute has embarked on one almost as ambitions—and without the resources of the federal government. Under the guidance of an able policy committee, Professors Stanley Surrey of Harvard and William Warren of Columbia are preparing what the institute modestly terms 'an improvement of the technical provisions of the present income-tax statute.' Its goals are many. It is seeking, first, the improvement of various technical provisions that 'breed litigation,' present unusual administrative difficulties, are too complex, or are absolete or inadequate. It is also seeking to fill gaps in the statute, improve ar-

rangement and language, and harmonize related provisions dealing with a single problem. It is to be hoped that these efforts, when they reach fruition, will be given serious consideration by Congress.

"But there are several reforms that need not and should not await the completion of a general overhaul. Only one would require legislation. The others are matters of administrative policy, which could be changed tomorrow if the Treasury gave the word:

"1. The Treasury should make it an invariable rule to give only 'prospective,' i.e., future, application to court decisions and its own interpretations when either represent radical change in tax thinking. This is now the general practice, but there should be no exceptions.

"2. Treasury litigation policies should be subjected to closer centralized supervision. An attempt should be made to take consistent positions on related matters. Of course, while a question remains undecided by the courts, the Treasury, as well as taxpayers, may question the ultimate outcome and so the department must occasionally argue inconsistent positions for a time. But this should be done openly and for the sole purpose of getting a judicial solution. Once that is available, it should be applied to all related issues wherever the chips may fall.

"3. The Treasury should step in where the courts have been unable to clarify a particular area. For example, a 1940 Supreme Court decision involving the

liability of the creator of a family trust for tax on the trust income was followed by a flood of litigation. The courts, dealing only with individual cases, cannot quickly evolve rules for measuring tax consequences of trusts with infinite variations. But in 1946 the Treasury issued a regulation explaining in detail the effect of various typical trust provisions. It received a mixed response from the tax bar. Many lawyers believed the department was 'legislating,' while others complained that, in some respects, the regulation was inconsistent with court decisions. The first group may have been right; the second certainly was, since almost any statement was bound to conflict with some court's utterances, so confused had the decisions become. Nevertheless, the regulation was a long step toward achieving reasonable certainty on the family-trust problem. Similar regulations on other matters could diminish unpleasant surprises for taxpayers.

"4. The Treasury should exercise its advisory ruling powers more promptly and more often. Defenders of the present system contend that any such relaxation would be followed by a flood of requests for rulings on all sorts of tax-avoidance schemes. This would be undesirable. And admittedly it is hard to let down bars 'just a little,' for the distinction between tax avoidance and the privilege of every taxpayer to pay the legal minimum is shadowy. Yet the Treasury is aware of the areas of greatest doubt. Requests for rulings on problems in these areas should be screened, the department should satisfy itself (after hearing the taxpayer) that the questions arise in connection with

bona fide business transactions and are not designed primarily to beat the law, and then it should issue an early ruling—with its reasons. In cases of favorable rulings, the taxpayer should be entitled to a closing agreement, irrevocably (except in case of fraud or a change in the statute) fixing the tax consequences after the facts presented by him have been verified. Where rulings are unfavorable or delayed, the taxpayer should be permitted to appeal to a specially constituted section of the Tax Court. Its sole function should be to pass on these appeals and issue declaratory (advisory) judgments, which, except for a government right of appeal, should be binding.

"Many objections may be anticipated. The scheme would increase the work of the Treasury and of the Tax Court (and the power to issue declaratory judgments could be given the court only by legislation). Tax advisers would doubtless shift the burden of many difficult decisions to the government. A taxpayer using such procedure and obtaining an unfavorable judgment would be at a disadvantage compared to one who proceeded with an identical transaction without a ruling and made it stand up. But if an increase in Treasury and Tax Court personnel would help, the cost would be relatively minor. That tax advisers will get good fees for passing the buck may be an irritation but hardly a serious objection. That some taxpayers might be burned is unfortunate, but there would be no compulsion to use the suggested procedure.

"5. Finally, to return to the problem illustrated by the Koppers case, the Commissioner of Internal Revenue should be obliged, after a court has given a decision, to announce his acquiescence or non-acquiescence, so that taxpayers may know where he stands, and thus where they stand.*

"Under the present system too much tax law is made after the event. Expansion of the Treasury's 'prenatal' activities should eliminate much of the present 'postnatal' litigation. If to this expansion are added the other suggested changes, and if Congress supplies a more adequate structure, a long step will have been taken toward dispersing the fog of uncertainty in which taxpayers now grope."

END

(from *Fortune*, April, 1951, Page 85)

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*Comment.—As stated at footnote (6)—page 15 of the petition herein—by merely applying the reorganization provisions of the statute, the Tax Court would have reached the same result in the *Koppers* case that it reached by applying the asset-purchase theory. Cf: 6 T.C. 1209, pp. 1219-1222, inclusive. It would have been futile, therefore, for the Commissioner to have appealed that decision.

An obvious reason for the failure of the Commissioner to "acquiesce" in the Koppers case is readily apparent. By not acquiescing therein, he has left himself free to contend for a strict construction of Sections 112(b)(6) and 113(a)(15) where greater tax liability would result therefrom.

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In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 196

KIMBELL-DIAMOND MILLING COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The *per curiam* opinion of the Court of Appeals (R. 161-162) is reported at 187 F. 2d 718. The findings of fact and opinion of the Tax Court (R. 124-136) are reported at 14 T. C. 74.

JURISDICTION

The judgment of the Court of Appeals (R. 162) was entered on March 16, 1951. A petition for rehearing was denied on April 23, 1951 (R. 169). The petition for a writ of certiorari was filed on

July 19, 1951. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTIONS PRESENTED

1. Whether the decision of the Tax Court in a prior action involving a different taxable year created an estoppel by judgment as to questions of fact which were presented but which the court expressly refrained from deciding.

2. Whether, on the facts before them, the courts below could hold that taxpayer's purchase of the entire stock of another corporation and the complete liquidation of that corporation within five days thereafter was a single transaction looking toward the purchase of the corporation's assets, so that the provisions of Section 113(a)(15) of the Internal Revenue Code, relating to the basis of assets acquired upon liquidation, were inapplicable.

STATUTE AND REGULATIONS INVOLVED

The applicable provisions of the statute and Regulations involved are set forth in the Appendix, *infra.*

STATEMENT

The facts as stipulated (R. 54-59) and as found by the Tax Court (R. 125-130) are as follows:

Taxpayer is a Texas Corporation engaged primarily in the business of milling, processing and selling grain products and has its principal office in Fort Worth, Texas. Taxpayer maintained its books and records and filed its corporation tax re-

turns on an accrual basis for a fiscal year ending May 31 of each year (R. 125).

On or about August 13, 1942, taxpayer's mill property at Wolfe City, Texas, was destroyed by fire. The assets so destroyed had an adjusted basis of $18,921.90. The property was insured; on or about November 14, 1942, taxpayer collected insurance in the amount of $124,551.10 ($118,200.16 as a reimbursement for the loss sustained by the fire and $6,350.94 as a premium refund). (R. 125.)

On December 26, 1942, taxpayer's directors approved a resolution (R. 126-127), in which, after reciting that the taxpayer intended "to replace its burned mill either by constructing a new mill or by purchasing facilities of a substantially similar kind and use" and that the Whaley Mill & Elevator Company owned such facilities, as well as other assets, it was resolved:

> 1. That the proper officers of Kimbell-Diamond Milling Company be, and they are hereby, authorized, empowered and directed to purchase the entire authorized, issued and outstanding capital stock of Whaley Mill & Elevator Company, a Texas corporation, consisting of 4,000 shares of the face or par value of $100.00 per share, for a sum not in excess of $210,000.00; that payment for the said stock of Whaley Mill & Elevator Company be made, to the extent possible, from the insurance proceeds deposited in a special account in the Fort Worth National Bank, and that the balance of the agreed consideration for the stock of

Whaley Mill & Elevator Company be paid out of the general funds of Kimbell-Diamond Milling Company.

2. That as soon as practicable after the purchase of the Whaley Mill & Elevator Company stock hereby authorized has been consummated, all necessary steps be taken to completely liquidate the said corporation by transferring its entire assets, particularly its mill and milling equipment, to Kimbell-Diamond Milling Company in cancellation and redemption of the entire issued and outstanding capital stock of Whaley Mill & Elevator Company, and that the charter of said corporation be forthwith surrendered and canceled.

On December 26, 1942, taxpayer acquired 100 per cent of the stock of Whaley for $210,000 in cash. This payment was, to the extent of $118,-200.16, made with the insurance proceeds received by taxpayer as a result of the fire. (R. 127.)

On December 29, 1942, the stockholders of Whaley assented to the dissolution and distribution of its assets. On the same date an "Agreement and Program of Complete Liquidation" was entered into between taxpayer and Whaley which provided, *inter alia* (R. 128-129):

That, Whereas, Kimbell-Diamond owns the entire authorized issued and outstanding capital stock of Whaley, consisting of 4,000 shares of a par value of $100.00 per share, which said stock was acquired by Kimbell-Diamond primarily for the purpose of enabling it to secure possession and ownership of the flour mill and

milling plant owned by Whaley, the parties herewith agree that the said mill and milling plant shall forthwith be conveyed to Kimbell-Diamond by Whaley under the following program for the complete liquidation of Whaley viz:

(1) Kimbell-Diamond shall cause the 4,000 shares of the capital stock of Whaley owned by it to be surrendered to Whaley for cancellation and retirement, whereupon Whaley shall forthwith convey, transfer and assign unto Kimbell-Diamond all property of every kind and character owned or claimed by it, particularly its flour mill and milling plant, located at Gainesville, Texas, and all machinery and equipment appurtenant thereto, or used in connection therewith, in full and complete liquidation of all of the outstanding stock of Whaley. The aforesaid distribution in complete liquidation shall be fully consummated by not later than midnight, December 31, 1942.

(2) When the entire assets of every kind and character, owned by Whaley, have been transferred to Kimbell-Diamond in full and complete liquidation of the capital stock of Whaley, owned by Kimbell-Diamond, Whaley shall forthwith make application to the Secretary of State of the State of Texas for its dissolution as a corporation and surrender its corporate charter.

On December 31, 1942, Whaley was dissolved, upon the consent of the taxpayer as its sole stockholder. (R. 56, 129.) The depreciable assets dis-

tributed to the taxpayer upon this dissolution had an adjusted basis to Whaley of $139,521.62. (R. 129.)

For the fiscal year ending May 31, 1943, the Commissioner determined certain deficiencies which resulted in proceedings in the Tax Court. *Kimbell-Diamond Milling Co.*, 10 T.C. 7. In that action the court held that the taxpayer's receipt of the insurance proceeds from the burning of its mill in 1942, and their expenditure to acquire the Whaley properties, was an involuntary conversion coming within Section 112(f) of the Internal Revenue Code, from which no gain should be recognized. A further issue was sought to be raised by the Commissioner's amended answer, in which he claimed additional deficiencies on the ground that he had erred in allowing petitioner to use, as its basis for the Whaley assets, their adjusted basis to Whaley, and that the correct basis for those assets was their cost to petitioner. On this issue the Tax Court, after pointing out (10 T.C. at 13) that the Commissioner had failed to satisfy his burden of coming forward with evidence, said (10 T.C. at 14):

> In this state of the record we prefer not to decide, in this proceeding, the legal question as to whether the purchase of shares in Whaley by the petitioner constitutes as a matter of law the acquisition of Whaley assets. We leave that question open for determination in any appropriate proceeding involving a later year, where a record presenting an adequate factual basis may be made. We shall let

the present case rest on the issue raised in the petition and answer, founded on the determination as made by the Commissioner in the first instance.

The present proceeding arises out of asserted deficiencies in income tax, declared value excess profit tax, and excess profit tax for the fiscal years ending May 31, 1945 and May 31, 1946 (R. 124). The only question at issue in the courts below and here is that of the correct basis to petitioner of the Whaley assets.[1] The Commissioner contended that the acquisition of the Whaley shares, the dissolution of Whaley and the transfer of its assets to petitioner, was a single transaction whose object and effect was the purchase of the Whaley assets, and that accordingly, petitioner's basis for those assets is, under Section 113(a) of the Internal Revenue Code, their cost to petitioner.[2] Petitioner contended that the purchase of the Whaley stock and the dissolution of Whaley were separate transactions, that so viewed the dissolution of Whaley was a complete liquidation of a subsidiary coming within Sections 112(b)(6) and 113(a)(15) of the Internal Revenue Code, and that accordingly its

[1] Determination of that question was conceded to control not only the depreciation allowable, but also the amount of taxpayer's equity invested capital on which its excess profits tax credit is computed (R. 135).

[2] Under Section 113(a)(9), Appendix, pp. 19-20, *infra*, that cost consists of $18,921.00 (the basis of the mill properties on account of which the insurance proceeds were received) plus $91,799.00 expended above the insurance proceeds, a total of $110,720.00. On taxpayer's theory, its basis would be $139,521.00.

basis was the adjusted basis to Whaley. It also contended that the prior proceedings were *res judicata* of the question of the proper basis.

On the foregoing facts, the Tax Court held that in view of the express reservations in the opinion, its prior decision was not an adjudication of any issue before it in the present proceeding (R. 133). On the merits, it held that "the purchase of Whaley's stock and the subsequent liquidation must be regarded as one transaction, namely, the purchase of Whaley's assets which was petitioner's sole intention" (R. 135). Accordingly it upheld the Commissioner's contention that the correct basis was the cost of those assets to petitioner. The Court of Appeals affirmed, *per curiam*. (R. 161.)

ARGUMENT

Section 112 (b)(6) of the Internal Revenue Code, Appendix, *infra*, and its corresponding basis provision, Section 113 (a)(15), Appendix, *infra*, declare the basis for assets acquired in the liquidation of a subsidiary under certain specified conditions to be the basis at which those assets were held in the hands of the subsidiary. The courts below held that the taxpayer here, however, in purchasing the stock of another corporation and liquidating it five days later did not come within the purview of these statutory provisions, since in substance the assets, and not the stock, of the other corporation were purchased; hence, the basis of the assets to the taxpayer is the cost of the

stock. This decision is a correct application of these statutory provisions to the facts of the instant case. The further holding that an earlier Tax Court decision (*Kimbell-Diamond Milling Co.* v. *Commissioner,* 10 T.C. 7) did not act as an estoppel by judgment precluding this result, is clearly in harmony with the decisions of this Court in *Commissioner* v. *Sunnen,* 333 U.S. 591, and *Tait* v. *Western Md. Ry. Co.,* 289 U.S. 620, and with settled principles.

1. The taxpayer's argument (Br. 21-30) that the earlier decision of the Tax Court in *Kimbell-Diamond Milling Co.* v. *Commissioner,* 10 T.C. 7, created a collateral estoppel which precluded adjudication of the merits of the instant case is without substance. Since different tax years are involved, the decision in the earlier action can act as an estoppel "only as to those matters in the second proceeding which were actually presented and determined in the first suit". *Commissioner* v. *Sunnen,* 333 U.S. 591, 598. Here the issue as to the proper basis was clearly not determined in the prior proceeding. The Tax Court unequivocally stated that it was deciding only the issues raised by the petition and answer and that "we prefer not to decide" the issue of the proper basis which the Commissioner sought to raise by his amended answer. It stated "we leave that question open for determination in any appropriate proceeding involving a later year, where a record presenting

an adequate factual basis may be made." (See pp. 6-7, *supra.*)

Petitioner argues that these express declarations that the issue of the proper basis was not determined were meaningless because the judgment approved a tax liability calculated by using the basis for which petitioner now contends. It is clear, however, that the fact that the judgment was so framed does not work a collateral estoppel where the issue was not actually determined in the prior proceeding. *Hartford Empire Co.* v. *Commissioner,* 137 F. 2d 540 (C.A. 2), certiorari denied, 320 U.S. 787.[3] Here the Tax Court in the earlier proceeding expressly refrained from determining the issue which is now contested. We can see no reason to give its judgment consequences which it did not intend, and to deny effect to its declarations that it did not determine that issue and that its judgment should be without prejudice to the right of the parties to contest that issue as to subsequent tax years.

2. The primary question here is factual—whether or not the formal liquidation of Whaley was really a liquidation at all for purposes of the statute, or was part of a larger transaction, i.e., a purchase of the assets of the Whaley Mill

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[3] In that case, although questions of basis were litigated in the prior proceeding, the Commissioner failed to make any objection to the use of the taxpayer's cost as the basis, and the judgment reflected the use of that cost. It was held that such a judgment did not preclude contention as to a later taxable year that the taxpayer's cost was not the proper basis.

and Elevator Company by taxpayer. We think it clear that the courts below correctly resolved that question. Taxpayer's avowed purpose was to "replace its burned mill" (R. 126) with comparable facilities. The resolution of its directors, approving the purchase of the entire stock of Whaley, stated (R. 126-127) that as soon as possible after the purchase of the stock they would liquidate the corporation and specified the terms on which such liquidation would take place. Three days later, a liquidation agreement was entered into between taxpayer and Whaley, which, *inter alia,* recited that the stock was acquired by taxpayer "primarily for the purpose of enabling it to secure possession of the flour mill and milling plant owned by Whaley" and obligated Whaley to transfer to taxpayer its assets and "particularly its flour mill and milling plant" (R. 128-129). Two days later Whaley was dissolved (R. 56). Thus, it is clear that the acquisition of stock and the immediate liquidation had a single purpose—the purchase of the mill properties. It is clear that each part of this transaction, with its separate obligations, would not have been undertaken except under a general prearranged plan; the purchase and liquidation were but two interdependent steps in a single transaction. See *Prairie Oil & Gas Co.* v. *Motter,* 66 F. 2d 309 (C.A. 10th); *Commissioner* v. *Ashland Oil & Refining Co.,* 99 F. 2d 588 (C.A. 6th), certiorari denied, 306

U.S. 661; *Mather* v. *Commissioner*, 149 F. 2d 393 (C.A. 6th), certiorari denied, 326 U.S. 767; *Tulsa Tribune Co.* v. *Commissioner*, 58 F. 2d 937 (C.A. 10th). Taxpayer's argument (Pet. 15) that the rule of these cases "was abrogated by the Congress by its enactment of Section 112 (b)(6)" of the Code is not convincing. We find nothing in the language or purpose of that provision which purports to abrogate or create an exception from the settled doctrine that a particular act may be denied independent tax significance if the trier of the facts finds that it was merely one of several interconnected steps in a single transaction. E.g. *Minnesota Tea Co.* v. *Helvering*, 302 U.S. 609.

Rather than abrogating the doctrine that the form of a transaction may be looked through in order to determine its true nature, the language and purpose of Section 112 (b)(6) support the conclusion of the courts below that the transaction here involved does not come within the intendment of that section. That section sets forth as one of the conditions precedent to its application:

> (A) the corporation receiving such property *was, on the date of the adoption of the plan of liquidation,* and has continued to be at all times until the receipt of the property, the owner of stock * * *. [Italics supplied.]

The legislative history [4] and purpose of the section

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[4] Section 112 (b)(6) was enacted in its present form by Section 112 of the Revenue Act of 1936, c. 690, 49 Stat. 1648,

clearly indicate that it was intended to apply only to a real existing parent-subsidiary situation and not to a parent-subsidiary situation of five days standing, which was entered into only for the admitted purpose of immediate liquidation. This section first appeared in Section 110 of the Revenue Act of 1935, c. 829, 49 Stat. 1014, which provided that the acquiring corporation must own the stock of the corporation to be liquidated at the time of the enactment of the statute (August 30, 1935.) In its original form it thus could not have been availed of by one who sought to obtain its benefits by purchasing stock for the purpose of immediately liquidating the subsidiary thus acquired. The substitution of "the date of the adoption of the plan of liquidation" for the original time—August 30, 1935—in later Acts and in the Internal Revenue Code does not reflect any change in the intendment of the taxing statute, but merely serves to make the statutory benefits available to future situations involving a real parent-subsidiary relationship.

Nothing in the decisions below is inconsistent with this Court's decision in *United States* v. *Cumberland Pub. Serv. Co.*, 338 U.S. 451. Indeed, this Court there re-emphasized the factual nature of cases of this type, stating (p. 456):

1679. It was specifically designed to facilitate the streamlining of corporate structures by encouraging parent corporations to liquidate subsidiaries, permitting such liquidations to be tax free under the conditions set forth.

> It is for the trial court, upon consideration of an entire transaction, to determine the factual category in which a particular transaction belongs.

Here the trial court (approved by the Court of Appeals) found that a purchase of assets occurred rather than a purchase of stock, and that conclusion is correct.[5]

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[5] The taxpayer's argument (Pet. 15-16) relative to Section 129 of the Internal Revenue Code is without merit. In the first place, the key to that section is the requirement that the principal purpose of the acquisition must be the avoidance of income tax. There is no showing of that in the instant case. And in any event, the application of Section 129 assumes the very point in controversy here, i.e., the applicability of Sections 112 (b)(6) and 113 (a)(15). Thus, this argument merely reverts to the original question as to whether there was a purchase of stock and liquidation here or only a purchase of assets.

CONCLUSION

The decision below is correct. There is no conflict in decisions and no other reason appears warranting review by this Court. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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Special Assistants to the Attorney General.

August, 1951.

Internal Revenue Code:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * *

(6) *Property received by corporation, on complete liquidation of another.*—No gain or loss shall be recognized upon the receipt by a corporation of property distributed in complete liquidation of another corporation. For the purposes of this paragraph a distribution shall be considered to be in complete liquidation only if—

(A) the corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 per centum of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends), and was at no time on or after the date of the adoption

of the plan of liquidation and until the receipt of the property the owner of a greater percentage of any class of stock than the percentage of such class owned at the time of the receipt of the property; and

(B) no distribution under the liquidation was made before the first day of the first taxable year of the corporation beginning after December 31, 1935; and either

(C) the distribution is by such other corporation in complete cancellation or redemption of all its stock, and the transfer of all the property occurs within the taxable year; in such case the adoption by the shareholders of the resolution under which is authorized the distribution of all the assets of such corporation in complete cancellation or redemption of all its stock, shall be considered an adoption of a plan of liquidation, even though no time for the completion of the transfer of the property is specified in such resolution; or

(D) such distribution is one of a series of distributions by such other corporation in complete cancellation or redemption of all its stock in accordance with a plan of liquidation under which the transfer of all the property under the liquidation is to be completed within three years from the close of the taxable year during which is made the first of the series of distributions under the plan, except that if such transfer is not completed within such period, or

if the taxpayer does not continue qualified under subparagraph (A) until the completion of such transfer, no distribution under the plan shall be considered a distribution in complete liquidation.

If such transfer of all the property does not occur within the taxable year the Commissioner may require of the taxpayer such bond, or waiver of the statute of limitations on assessment and collection, or both, as he may deem necessary to insure, if the transfer of the property is not completed within such three-year period, or if the taxpayer does not continue qualified under subparagraph (A) until the completion of such transfer, the assessment and collection of all income, war-profits, and excess-profits taxes then imposed by law for such taxable year or subsequent taxable years, to the extent attributable to property so received. A distribution otherwise constituting a distribution in complete liquidation within the meaning of this paragraph shall not be considered as not constituting such a distribution merely because it does not constitute a distribution or liquidation within the meaning of the corporate law under which the distribution is made; and for the purposes of this paragraph a transfer of property of such other corporation to the taxpayer shall not be considered as not constituting a distribution (or one of a series of distributions) in complete cancellation or redemption of all the stock of such other corporation, merely because the carrying out of the plan involves (i) the trans-

fer under the plan to the taxpayer by such other corporation of property, not attributable to shares owned by the taxpayer, upon an exchange described in paragraph (4) of this subsection, and (ii) the complete cancellation or redemption under the plan, as a result of exchanges described in paragraph (3) of this subsection, or if the shares not owned by the taxpayer.

* * * * *

(26 U.S.C. 1946 ed., Sec. 112.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (unadjusted) or property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(9) *Involuntary conversion.*—If the property was acquired, after February 28, 1913, as the result of a compulsory or involuntary conversion described in section 112 (f), the basis shall be the same as in the case of the property so converted, decreased in the amount of any money received by the taxpayer which was not expended in accordance with the provisions of law (applicable to the year in which such conversion was made) determining the taxable status of the gain or loss upon such conversion, and increased in the amount of gain or decreased in the amount of loss to the taxpayer recognized upon such conversion under the law ap-

plicable to the year in which such conversion was made.

* * * * *

(15) *Property received by a corporation on complete liquidation of another.*—If the property was received by a corporation upon a distribution in complete liquidation of another corporation within the meaning of section 112 (b) (6), then the basis shall be the same as it would be in the hands of the transferor. The basis of property with respect to which election has been made in pursuance of the last sentence of section 113 (a) (15) of the Revenue Act of 1936, as amended, shall, in the hands of the corporation making such election, be the basis prescribed in the Revenue Act of 1934, as amended.

* * * * *

(26 U.S.C. 1946 ed., Sec. 113.)

SEC. 718 (as added by Sec. 201, Second Revenue Act of 1940, c. 757, 54 Stat. 974). EQUITY INVESTED CAPITAL.

(a) *Definition.*—The equity invested capital for any day of any taxable year shall be determined as of the beginning of such day and shall be the sum of the following amounts, reduced as provided in subsection (b)—

* * * * *

(5) *Increase on account of gain on tax-free liquidation.*—In the case of the previous

receipt of property (other than property described in the last sentence of section 113 (a) (15)) by the taxpayer in complete liquidation of another corporation under section 112 (b) (6), or the corresponding provision of a prior revenue law, an amount, with respect to each such liquidation, equal to the amount by which the aggregate of the amount of the money so received and of the adjusted basis, at the time of receipt, of all property (other than money) so received, exceeds the sum of:

(A) The aggregate of the adjusted basis of each share of stock with respect to which such property was received; such adjusted basis of each share to be determined immediately prior to the receipt of any property in such liquidation with respect to such share, and

(B) The aggregate of the liabilities of such other corporation assumed by the taxpayer in connection with the receipt of such property, of the liabilities (not assumed by the taxpayer) to which such property so received was subject, and of any other consideration (other than the stock with respect to which such property was received) given by the taxpayer for such property so received.

* * * * *

(26 U.S.C. 1946 ed., Sec. 718.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.112 (b) (6)-5. RECORDS TO BE KEPT AND INFORMATION TO BE FILED WITH RETURN.—

(a) Permanent records in substantial form shall be kept by every corporation receiving distributions in complete liquidation within the exception provided in section 112 (b) (6) showing the information required by this section to be submitted with its return. The plan of liquidation must be adopted by each of the corporations parties thereto; and the adoption must be shown by the acts of its duly constituted responsible officers, and appear upon the official records of each such corporation.

(b) For the taxable year in which the liquidation occurs, or, if the plan of liquidation provides for a series of distributions over a period of more than one year, for each taxable year in which a distribution is received under the plan, the recipient shall file with its return a complete statement of all facts pertinent to the nonrecognition of gain or loss, including—

(1) A certified copy of the plan for complete liquidation, and of the resolutions under which the plan was adopted and the liquidation was authorized, together with a statement under oath showing in detail all transactions incident to, or pursuant to, the plan.

(2) A list of all the properties received upon the distribution, showing the cost or other basis of such properties to the liquidat-

ing corporation at the date of distribution and the fair market value of such properties on the date distributed.

(3) A statement as to its ownership of all classes of stock of the liquidating corporation (showing as to each class the number of shares and percentage owned and the voting power of each share) as of the date of the adoption of the plan of liquidation, and at all times since, to and including the date of the distribution in liquidation, and the cost or other basis of such stock.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM 1951

No. 196

KIMBELL-DIAMOND MILLING COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

PETITIONER'S REPLY TO BRIEF FOR THE RESPONDENT IN OPPOSITION

Introduction

We respectfully submit to the Court the following reply to the brief for the respondent in opposition to the granting of certiorari herein.

Reply Argument

I.

Admittedly, since different tax years are involved, the decision of the Tax Court in the earlier *Kimbell-Diamond Milling Company case* can act as an estoppel in the present proceeding "only as to those matters in the second proceeding which were actually presented and determined in the first suit." *Commissioner* v. *Sunnen*, 333 U.S. 591, 598.

In the brief filed by respondent in opposition to the granting of certiorari herein, respondent concedes that the judgment of the Tax Court in the earlier case of *Kimbell-Diamond Milling Company* v. *Commissioner*, 10 T.C. 7, approved a tax liability calculated by using the identical basis for which petitioner now contends. Respondent asserts, however, (Br., page 10) that the fact that the judgment was so framed does not work a collateral estoppel, and cites *Hartford-Empire Company* v. *Commissioner*, 137 F. (2d) 540 (C.A. 2), certiorari denied, 320 U.S. 787, as supporting this contention.

In so contending, and in representing to this Court that his position in the matter is supported by the authority cited, respondent neglected to inform the Court regarding fundamental differences that existed between the underlying situation present in the case at Bar, and that before the Court of Appeals for the

Second Circuit in *Hartford-Empire Company* v. *Commissioner, supra.*

In the earlier *Kimbell-Diamond Milling Company case,* the proceeding before the Tax Court was litigated to the very end. The judgment of the Tax Court was its own judgment, independently arrived at, and entered solely upon the basis of the pleadings, and the evidence adduced at the trial. As we have shown in our opening brief, (Br. pp. 21-31) it was a *determination by that Court* of all of the issues involved in the case then before it, including the basis issue.

In *Hartford-Empire Company* v. *Commissioner, supra,* the situation was directly to the contrary. In the earlier *Hartford-Empire Company case,* the parties stipulated the "cost" of certain patents. The issues submitted for the decision of the Court by the pleadings and briefs of the parties in the first proceeding were confined to two questions, viz.: (1) Whether the taxpayer there was entitled to any allowance at all for the exhaustion of its patents; and (2) whether the taxpayer should be allowed to carry over the earlier year loss of a predecessor corporation.

In deciding the estoppel issue raised in the second *Hartford-Empire Company case,* the Court (137 F. (2d) 540, 541) said:

> "The first question is whether this decision (the earlier Tax Court judgment entered pursuant to a stipulation between the parties litigant) required

the Commissioner to use the same 'basis' for depreciation for the years now in question. That the Tax Court's former orders were a conclusive bar for the years 1923 to 1928 nobody disputes; but each year's tax is a separate 'cause of action' in the sense that that phrase is used for purposes of estoppel, and the estoppel depends upon whether the actual point was decided and was necessary to the decision. It is true that the Tax Court's actual orders assessing the deficiency—the final judgments—could not have been entered as they were unless the 'basis' for depreciation of the Empire and Howard patents had been taken at their cost to the taxpayer; but *actually the Court could not decide that question at all, for the stipulation did not present to it any other 'basis' for depreciation of the patents.* If the orders created any estoppel, it was therefore because the Commissioner had conceded the point and judgment had been entered upon his concession. *Had the issue—though it was an issue of law—been actually litigated and decided, we may assume arguendo that the Commissioner would have been estopped. Tait* v. *Western Maryland Railway Co.*, 289 U.S. 620, 53 S.Ct. 660, 77 L. Ed. 1470. Indeed, we may also assume that, since the petitions alleged and the Commissioner denied that the 'cost' to the taxpayer had been in the amounts stated and since the parties had agreed to the amounts, any future dispute about the amount was precluded, if that ever became relevant to a later contest between the parties. Restatement of Judgments, Sec. 68; Comment f, top of p. 304." (Matter in parentheses and emphasis supplied.)

We respectfully submit that *Hartford-Empire Company* v. *Commissioner*, *supra*, cited and relied upon

by respondent as controlling the disposition of the estoppel issue present in the instant proceeding, far from furnishing grounds for the denial of certiorari in the case at Bar, advances cogent reasoning why the petition herein for certiorari should be granted.

II.

The decisions below, and respondent's brief in opposition to the granting of certiorari herein, both confuse *purpose*, and ultimate *result*, with the "substance" of what was done, differences this Court, in the past, has had no difficulty in recognizing and giving effect to.

It should first be observed that, in the case at Bar, we are not concerned with a statutory "re-organization," and the doctrine that, in such cases, a particular act may be denied independent tax significance if the trier of facts finds that it was merely one of several interconnected steps in an over-all plant of reorganization (Cf: *Minnesota Tea Company* v. *Helvering*, 302 U.S. 609) has no application.

Concededly, in tax matters, as in other litigation, it is proper, where material, to look through "form" and be guided by "substance." Thus an instrument that in form is an absolute conveyance, but is intended by the parties to be, and is, a mere security device, will be recognized as such. *Helvering* v. *F. & R. Lazarus & Co.*, 308 U.S. 252. And where a corporation has made an effective sale of assets, and then proceeds to

dress the transaction in the guise of a purported liquidation followed by a stockholders sale, effect will be given to what was actually done. *Commissioner* v. *Court Holding Company*, 324 U.S. 331.

This does not mean, however, that, where there are two permissible methods of reaching a given end result, each of which methods has differing tax consequences, what is actually done can be ignored, and the transaction treated as being in "substance" something other than what it actually was. *United States* v. *Cumberland Public Service Company*, 338 U.S. 451; *Appeal of Minnie C. Brackett, Administratrix*, 19 B.T.A. 1154.

In the case at Bar, the taxpayer did exactly what it purported to do. It bought the entire capital stock of Whaley Mill and Elevator Company and thereafter dissolved that corporation. The legal effect of what was thus actually done is governed by the controlling provisions of express and unambiguous statutes. Such legal effect may not be changed or varied by saying that the "substance" of the transaction was something other than it actually was, merely because the same end result might have been reached in another way, to-wit, by a direct purchase of assets. *United States* v. *Cumberland Public Service Company, supra.*

The parties having stipulated (R. 55) and the Tax Court having twice found (10 T.C. 7, page 9, and R. 127) that petitioner acquired the entire capital stock of Whaley Mill and Elevator Company, and thereafter liquidated that corporation, under the plain language

of Sections 112(b)(6) and 113(a)(15) of the Internal Revenue Code, petitioner is clearly entitled to Whaley's basis for the assets acquired by it in connection with the complete liquidation of Whaley.

Conclusion

For the foregoing reasons, and for the reasons set out in the petition and the brief in support thereof, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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